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No. 2731

IN THE

Supreme Court of the United States

OCTOBER TERM, 1947

SOUTH TEXAS COMMERCIAL NATIONAL BANK OF HOUSTON, *Petitioner*

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent*

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT AND BRIEF IN SUPPORT THEREOF

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TEXAS CO., HOUSTON

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT

May it please the Court:

The petitioner, South Texas Commercial National Bank of Houston, respectfully prays for a writ of certiorari to the United States Circuit Court of Appeals for the Fifth Circuit at New Orleans, Louisiana, to hear this cause and to review the decision of the Circuit Court of Appeals in affirming the judgment of The Tax Court of the United States. Petitioner respectfully shows to this Honorable Court:

1.

Summary Statement of the Matter Involved

The parties agreed that this case is controlled by Sections 23(p) and 165 of the Internal Revenue Code prior to amendment by the Revenue Act of 1942.

(Opinion of Tax Court, R. 33). Those sections are set out in our supporting brief.

Section 23(p) provided that

> "An employer establishing or maintaining a pension fund to provide for the payment of *reasonable pensions to his employees*"

might spread as income tax deductions over a period of ten years his contributions to the trust if the trust were exempt from the income tax under Section 165. The latter section provided that a trust forming part of a pension plan for the exclusive benefit of *some or all* of the employees should be exempt if contributions to the trust were for the purpose of distributing to the employees the earnings and principal and

> "(2) if under the trust instrument it is impossible at any time prior to the satisfaction of all liabilities with respect to employees under the trust, for any part of the corpus or income to be (within the taxable year or thereafter) used for, or diverted to, purposes other than for the exclusive benefit of his employees."

With these three simple and clear tests in mind and with the thought of creating a flexible pension plan that would work out for the greatest good of its employees, petitioner executed a pension trust agreement (R. 16-28) on January 9, 1940, with itself as trustee, and contributed to the trust $150,000 in 1940, $85,000 in 1941, and $165,000 on or prior to June 15, 1942. The sole question in this case is whether petitioner was entitled to deduct for each of these years

one-tenth of its contributions made during each year and prior years.

Petitioner did not want to require its employees to bear any cost of the pension plan. Likewise it realized that the financial condition of employees when they come to retirement varies widely. Petitioner realized that, if it adopted a plan under which all employees would receive an automatically fixed pension depending upon their length of service, salary received, and other fixed factors, this would be a rigid plan and an employee who might have no financial resources would be restricted to a small pension the same as a similar fellow employee who might have independent resources of his own. After many inquiries among other banks as to their pension plans (R. 81-82), petitioner on January 9, 1940, executed in its individual capacity a trust agreement with itself as Trustee, ultimately contributing $400,000 of its own funds to the trust. The trust agreement provided that the trust estate should be administered and distributed solely for the purpose of paying pensions to petitioner's employees and that under no circumstances could any part of the trust estate, the income therefrom or accumulations thereof, ever be distributed to, or enure to the benefit of, the petitioner. The trust was made irrevocable except that petitioner reserved the right to modify such of its provisions as experience might show advisable to effect a more advantageous administration of the trust estate and the better accomplishment of its purposes.

In order that the pension trust might work to the

greatest advantage of the employees, it was provided that pensions should be paid to such employees of the Bank as the Trustee might from time to time determine with a minimum pension of $25 per month and a maximum of $250 per month.

The case was tried upon the petition and answer, a stipulation and the testimony of Mr. E. F. Gossett, the then Chairman of the Board of Directors of petitioner. Complete financial records of the administration of the trust were introduced showing its operations from January 9, 1940, through December 31, 1945, which showed that the income was used solely for the payment of pensions to employees except that any unexpended balance was added to the corpus.

It will be borne in mind that this trust was created prior to the detailed and complicated provisions of Sections 23(p) and 165 of the Internal Revenue Code enacted by the Revenue Act of 1942, which Act for the first time set up many detailed requirements as to the method of computing pensions and likewise for the first time required detailed formulas under which the amount of pensions to be paid could be determined.

As the law stood in 1940, Treasury Regulations 103 (set out in our supporting brief), Section 19.23(p)-1, referred to an employer adopting "a reasonable pension plan, actuarily sound." This is entirely different from the wording of Section 23(p) of the Act itself, above referred to, which does not speak of a "reasonable pension plan" or one that is "actuarily sound,"

but simply refers to "a pension trust to provide for the payment of reasonable pensions." (In this case no question was raised by the Government as to the reasonableness of the pensions to be paid under the trust or of the amount contributed by petitioner to the trust fund.) The Government in its argument in The Tax Court and the Circuit Court of Appeals seized upon these quoted parts of the Regulations and took the position that a pension plan must have a rigid formula under which pensions could be determined and that it must include all employees. In other words, the Government and the courts below actually applied in substance the detailed provisions of the Revenue Act of 1942. Although the Code did not refer to a "reasonable pension plan," both The Tax Court and the Circuit Court of Appeals held that there must be a "reasonable pension plan," that petitioner's pension trust was not a "reasonable pension plan" because it set up no formula upon which pensions were to be computed, and petitioner was therefore not entitled to the deductions.

The income taxes involved were for the years 1940, 1941 and 1942.

2.

Statement Disclosing Basis Upon Which it is Contended this Court Has Jurisdiction

Jurisdiction of this cause is conferred upon this Honorable Court by Judicial Code, Section 240, as amended; United States Code, Title 28, Section 347.

3.

Question Presented

Were The Tax Court of the United States and the Circuit Court of Appeals for the Fifth Circuit authorized in holding that, under Sections 23(p) and 165 of the Internal Revenue Code prior to the Revenue Act of 1942, petitioner was not entitled to deduct under those sections as an expense each year one-tenth of its contributions to the pension trust made during that year and prior years?

Reasons Relied on for the Allowance of the Writ

The reasons relied on for the allowance of the writ are that the Circuit Court of Appeals has decided important questions of Federal law which have not been and should be settled by this Court.

The Circuit Court of Appeals and The Tax Court held that, although Sections 23(p) required merely that the plan be for the payment of *reasonable pensions,* nevertheless, a pension plan to qualify under Section 23(p) must be a "reasonable plan" even though the pensions to be paid thereunder would be *reasonable pensions,* the only test established by the Act. No test as to what would constitute a reasonable plan was stated by either of the lower courts, but it was clearly inferred in the light of the arguments of the Government that fixed formulas for computing pensions must exist and the plan must apply to substantially all employees. Such holding is contrary to the only test of Section 23(p) that the pensions must

be reasonable and to the permission granted in Section 165 that the plan may be for *some or all* of the employees. On the latter point their holdings are in conflict with the decision of the Board of Tax Appeals in *Albert W. Harris v. Commissioner,* Docket Nos. 92482-92486 (Commerce Clearing House Decision 10,864-A) decided by Board of Tax Appeals on October 27, 1939, just prior to the creation of this pension trust. Many other pension trusts were created with the same general plan in view as the present one, and the proper interpretation of these two sections of the Internal Revenue Code should be settled by this Court.

This is the first case in which the Government has advanced its present construction of these sections, as shown by the statement by the Tax Court in its opinion (R. 34):

> "We have not been furnished by either the petitioner or respondent with any authorities to sustain their respective views on the question of the taxability of this trust to the settler thereof."

WHEREFORE, your petitioner respectfully prays that a writ of certiorari may issue out of and under the seal of this Honorable Court directed to the United States Circuit Court of Appeals for the Fifth Circuit commanding said Court to certify and send to this Court on a day certain, to be therein designated, a full and complete transcript of the record of all of the proceedings in the Circuit Court of Appeals in said cause entitled *South Texas Commercial National*

Bank of Houston, Petitioner v. Commissioner of Internal Revenue, Respondent, No. 11902 on its docket, to the end that said cause may be reviewed and determined by this Court as provided by Section 240 of the Judicial Code, as amended, and that your petitioner may have such other and further relief or remedy in the premises as this Court may deem appropriate and in conformity with said provisions of the Judicial Code, and that on hearing before this Honorable Court said judgments of the Circuit Court of Appeals and of The Tax Court of the United States be reversed by this Honorable Court and such relief granted as is appropriate to the cause.

SOUTH TEXAS COMMERCIAL NATIONAL BANK OF HOUSTON

By HOMER L. BRUCE
Attorney for Petitioner

No. .....

IN THE

Supreme Court of the United States

OCTOBER TERM, 1947

SOUTH TEXAS COMMERCIAL NATIONAL BANK OF HOUSTON, *Petitioner*

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent*

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

I.

The Opinions of the Courts Below

The opinion of The Tax Court of the United States is reported in 7 T. C. 764 and is found at page 30 of the record. The opinion of the Circuit Court of Appeals has not been reported but is found at page 109 of the record.

II.

Jurisdiction

Stated under heading 2 of the petition.

III.

Statement of the Case

A full statement of the case has been given under heading 3 of the petition and in the interest of brevity is not repeated.

IV.

The Law

Sections 23(p) and 165 of the Internal Revenue Code prior to their amendment by the Revenue Act of 1942 are as follows:

"Sec. 23. In computing net income there shall be allowed as deductions:

* * *

"(p) PENSION TRUSTS.—

"(1) GENERAL RULE.—An employer establishing or maintaining a pension trust to provide for the payment of reasonable pensions to his employees shall be allowed as a deduction (in addition to the contributions to such trust during the taxable year to cover the pension liability accruing during the year, allowed as a deduction under subsection [a] of this section) a reasonable amount transferred or paid into such trust during the taxable year in excess of such contributions, but only if such amount (1) has not theretofore been allowable as a deduction, and (2) is apportioned in equal parts over a period of ten consecutive years beginning with the year in which the transfer or payments is made.

"(2) DEDUCTIONS UNDER PRIOR INCOME TAX ACTS.—Any deduction allowable under section 23(q) of the Revenue Act of 1928, 45 Stat. 802, or the Revenue Act of 1932, 47 Stat. 182, or the Revenue Act of 1934,

48 Stat. 691, under section 23(p) of the Revenue Act of 1936, 49 Stat. 1661, or the Revenue Act of 1938, 52 Stat. 464, which under such section was apportioned to any taxable year beginning after December 31, 1937, shall be allowed as a deduction in the years to which so apportioned to the extent allowable under such section if it had remained in force with respect to such year.

"(3) EXEMPTION OF TRUSTS UNDER SECTION 165.—The provisions of paragraphs (1) and (2) of this subsection shall be subject to the qualification that the deduction under either paragraph shall be allowable only with respect to a taxable year (whether the year of the transfer or payment or a subsequent year) of the employer ending within or with a taxable year of the trust with respect to which the trust is exempt from tax under section 165."

"Sec. 165. (a) EXEMPTION FROM TAX.—A trust forming part of a stock bonus, pension, or profit-sharing plan of an employer for the exclusive benefit of some or all of his employees—

"(1) if contributions are made to the trust by such employer, or employees, or both, for the purpose of distributing to such employees the earnings and principal of the fund accumulated by the trust in accordance with such plan, and

"(2) if under the trust instrument it is impossible, at any time prior to the satisfaction of all liabilities with respect to employees under the trust, for any part of the corpus or income to be (within the taxable year or thereafter) used for, or diverted to, purposes other than for the exclusive benefit of his employees,

shall not be taxable under section 161, but the amount actually distributed or made available to any distributee shall be taxable to him in the year in which

so distributed or made available to the extent that it exceeds the amounts paid in by him. Such distributees shall for the purpose of the normal tax be allowed as credits against net income such part of the amount so distributed or made available as represents the items of interest specified in section 25(a)

"(b) TAXABLE YEAR BEGINNING PRIOR TO JANUARY 1, 1940.—The provisions of clause (2) of subsection (a) shall not apply to a taxable year beginning prior to January 1, 1940."

The applicable Treasury regulations are very extended and are therefore set out as Appendix A hereto.

Sections 23(p) and 165 of the Internal Revenue Code as amended by the Revenue Act of 1942 are set out as Appendix B hereto.

V.

Specification of Errors

1. The Circuit Court of Appeals erred in affirming the judgment of The Tax Court because the petitioner was entitled to the deductions claimed.

2. The Circuit Court of Appeals erred in holding that the pension plan involved in a case like this one must be a reasonable plan, and in holding that the present one was not a reasonable plan and therefore petitioner was not entitled to the deductions claimed.

3. The Circuit Court of Appeals erred in holding that the pension plan involved in this case did not qualify as an exempt plan under Section 165 of the

Internal Revenue Code so as to allow petitioner the deductions claimed in this case.

4. The Circuit Court of Appeals erred in affirming the holding of the Tax Court that petitioner reserved to itself the power of doing everything with the fund in the pension trust that an owner could do.

5. The Circuit Court of Appeals erred in affirming the action of the Tax Court in sustaining the objections of the respondent to, and refusing to admit in evidence, all evidence of petitioner as to the operations of the pension trust, and the nature of petitioner's condition, during the years 1943, 1944 and 1945.

ARGUMENT

Summary of Argument

Point A

The pension trust met every requirement of Section 165 of the Internal Revenue Code as it existed in 1940, 1941 and 1942, and the petitioner was therefore entitled under Section 23(p) to take the deductions claimed.

Point B

As the respondent contended that the pension trust was not exempt under Section 165 of the Internal Revenue Code because the trust fund was not for the exclusive benefit of petitioner's employees, the evidence offered by petitioner as to the actual financial operations of the trust fund and of the pensions paid during 1943, 1944 and 1945, down to the trial of this case, was improperly excluded by the Tax Court on objections by the respondent even though 1942 was the last tax year involved.

Point A

At all times an employer's right to deduct under

Section 23(p) contributions to a pension trust has depended upon whether the trust was under Section 165 exempt from taxation.

This trust was drawn up in the fall of 1939 and adopted by the stockholders of petitioner on January 9, 1940, long before the detailed and intricate restrictions placed in those sections by the Revenue Act of 1942, which are set out in Appendix B hereto. At that time the tests to be met were simple and seemed to petitioner clear and unequivocal. With these in view it created this trust and irrevocably contributed $400,000 of its own money with the sanguine and thoroughly justified belief that it could spread this amount as deductions over a period of ten years. The only requirements of Section 23(p) were that the trust be one for the payment of reasonable pensions and that the trust be exempt under Section 165. Certainly it met the first test by providing that the amount of a pension should be left to the discretion of the trustee within the limits of $25 and $250 per month. No charge has been made by the Government that those amounts were exorbitantly high nor has it questioned their reasonableness.

The tests under Section 165 as to the exempt character of the trust were:

1. The pension plan must be for the exclusive benefit of *some or all* of the employees.

2. The trust must be for distributing the earnings and principal of the trust fund to the employees in accordance with the plan.

3. It must be impossible, prior to the satisfaction of all liabilities to the employees being paid, for any part of the corpus or its earnings to be used except for the exclusive benefit of the employees.

In January, 1940, (long before the drastic changes in these tests made by the Revenue Act of 1942 had even been thought of) petitioner endeavored meticulously to meet, and thought it had met, every one of these tests.

The first test said the trust must be for "the exclusive benefit of some or all" of the employees. Unlike the 1942 Act, the Code made no provision for a minimum percentage of employees to be covered. The trust agreement in Section 3 (R. 18) provided that the trust was created *solely* for paying pensions to the employees. Section 4 (R. 18) provided that the trustee, acting as trustee of the trust fund, should pay such pensions to such employees as it as trustee should deem desirable, within the $25 and $250 per month limits. Sections 18 and 19 (R. 24-25) provided that, if petitioner were dissolved or the trust terminated, the trustee should distribute the trust fund solely among the employees. Section 21 (R. 25) expressly provided that no part of the trust fund or its income should ever be distributed to, or enure to the benefit of, petitioner. Section 22 (R. 26) made the trust irrevocable.

This trust clearly met the first two tests—exclusive benefit of some or all of the employees and distribution of the earnings and principal to the employees.

As to the third test it went even further than the Code required. Under that test, if a pension plan set up a formula under which pensions were to be computed and it developed that too great an amount had been placed in the trust fund to discharge these liabilities, the employer could take down the excess and the trust would still be exempt. Since no formulas were in this trust by which a fixed pension liability could be computed, this trust specifically provided that no part of the trust fund could ever come back to petitioner. That this provision more than met this third test is forcefully brought out by its legislative history.

For a long time prior to the Revenue Act of 1938 Section 165 was so drawn that an employer could create a pension trust, allow it to run for several years, take his income tax deductions, and then revoke the trust and recover whatever was left of the trust fund. That Section 165 prior to 1938 read as follows (copied from Revenue Act of 1936):

> "SEC. 165. EMPLOYEES' TRUSTS.
>
> "A trust created by an employer as a part of a stock bonus, pension, or profit-sharing plan for the exclusive benefit of some or all of his employees, to which contributions are made by such employer, or employees, or both, for the purpose of distributing to such employees the earnings and principal of the fund accumulated by the trust in accordance with such plan, shall not be taxable under Section 161, but the amount actually distributed or made available to any distributee shall be taxable to him in the year in which so distributed or made available to the extent

that it exceeds the amounts paid in by him. Such distributees shall for the purpose of the normal tax be allowed as credits against net income such part of the amount so distributed or made available as represents the items of interest specified in Section 25 (a)."

To remedy this situation the House Ways and Means Committee in 1938 proposed to change Section 165 to provide that *no part of the pension fund might ever under any circumstances be taken back by the employer.* In its report to the House it stated (Cumulative Bulletin 1939-1 [Part 2] pages 761-762):

"Section 165. Employees' Trusts.

"Under existing law a trust created by an employer as a part of a stock bonus, pension, or profit-sharing plan for employees may be exempt from income tax even though it is possible for the employer to revoke or alter the trust at any time, so as to deprive his employees of substantial benefits which they expected to receive. Section 165 of the bill provides that for taxable years beginning after December 31, 1938, *unless it is impossible* under any provision of the trust instrument (including any collateral agreements or arrangements) *for any part of the trust corpus or income thereof to be at any time used for, or diverted to, purposes other than the exclusive benefit of employees,* the trust shall be taxable under Section 161. The trust is taxable if the use or diversion may occur through the exercise of a power by any person or persons or through termination of the trust after a designated period or upon the happening of a contingency, and is taxable if the use or diversion may be for the benefit of any person (whether the employer or some other person) other than employees."

The Senate Finance Committee in its report (same Cumulative Bulletin, page 796) pointed out that *the bill as introduced in the House went too far* and therefore it changed the bill to allow any part of the trust fund not needed to satisfy liabilities to employees to revert to the employer, saying in its report as follows:

> "Section 165. Employees' Trusts.
>
> "This section of the House bill, relating to the exemption from tax of employees' trusts, is retained in the bill, *except with a change which is deemed advisable in fairness to employers.* Under the House bill an employees' trust, for taxable years beginning after December 31, 1938, is not exempt from tax if it is possible at any time for any part of the trust principal or income to be used for, or diverted to, purposes other than the exclusive benefit to employees. However, it is quite possible that after satisfaction of all pension liability under the trust, an additional amount of funds of the trust will remain, due to erroneous actuarial computations during the previous life of the trust. It seems desirable to allow the employer to provide for the return of such an amount in the trust without the trust losing its exempt status under Section 165. Of course, under the provisions of Section 23 (p), the amount recovered by the employer must be reported by him as income. Accordingly, Section 165 of the reported bill provides that an employee's trust will be exempt from tax if at any time before the pension liabilities with respect to employees under the trust have been satisfied it is impossible for any part of the trust fund, including principal and income, to be used for, or diverted to, purposes other than the exclusive benefit of employees."

As shown by the report to the House from the Committee of Conference (same Cumulative Bulletin, page 827) referring to Amendment No. 97, the House concurred in the Senate change.

As is apparent from the above, if an employer had created a trust with definite pensions payable to employees worked out on an actuarial basis and actual experience showed that, after all liabilities to the employees had been satisfied, there still remained any money in the trust fund, this money could revert to the employer and still the trust would be exempt. On the other hand, in this case there is absolutely no contingency under which any part of this trust fund can ever revert to this taxpayer.

In the House version of Section 165, if no part of the trust fund could ever revert to the employer, *just as in this case,* the trust would be exempt. The Senate Finance Committee followed the House

> "except with a change *which is deemed advisable in fairness to employers.*"

This change was to insert the words

> "at any time prior to the satisfaction of all liabilities with respect to employees under the trust."

We submit that this trust met every possible test under Section 165.

As against this plain meaning of Sections 23(p) and 165, the Government has seized upon the first few words of Section 19.23(p)-1 of Treasury Regulations under Section 23(p) reading

> "An employer who adopts or has adopted a reasonable pension plan, actuarily sound,"

and has therefore argued, and thereby prevailed in the lower courts, that a pension trust must set up some formula for computing pensions which must work out on a reasonably fair basis to all employees and the formula must be actuarially sound in relation to the amount contributed to the trust by the employer. This position of the Government is a pure afterthought inspired by the radical changes made by the Revenue Act of 1942. At no place did the Code in 1940 use or refer to "a reasonable plan, actuarially sound," but on the other hand referred merely to "a pension trust to provide for the payment of *reasonable pensions.*"

This point has never been raised by the Government in any other case, and the only discussion of these words in the regulations in all the tax literature we have been able to find is the following from 4 *Mertens, Law of Federal Income Taxation,* Section 25.74, page 462:

> "By 'actuarially sound' the regulations probably mean to require that the fund must be sufficient to provide for proposed payments under the normal life expectancies of the employees covered by the plan, on the one hand, and on the other that it shall not offer a hiding place for excessive accumulations."

Within this meaning of the term this plan was "actuarially sound." The $400,000 was sufficient to pay the proposed pensions as the trustee would pay

only such pensions as the fund would bear, and the Government has at no time contended that this amount was an "excessive accumulation."

The Circuit Court of Appeals, without giving any basis for its holding, merely stated:

> "We agree with the Tax Court that the petitioner did not establish a reasonable pension plan and was not entitled to the deductions." (R. 111.)

We must therefore turn to the opinion of the Tax Court. The following excerpts fairly represent its reasoning:

> "While it is true that the early concept of pensions involved the whimsical charity of the sovereign and that there was generally little distinction between gratuities, charity and pensions, nevertheless our more modern concept of pensions involves a far more definite idea than the mere charitable whim of the pension payor. (R. 34-35.)
>
> * * *
>
> "It is thus evident that the bank in creating this trust desired to create a fund out of which it could in the future bestow its charity on its old employees. It desired to be in a position to pay those whom it considered had rendered the most valuable and loyal services more than those who had not rendered services which it valued so highly, and also to pay those who were in need relatively larger amounts, while those who were able to finance themselves should receive little or nothing. Such an arrangement whereby an employer retains the power to 'sprinkle its beneficences' among a selected segment of its em-

ployees, through the medium of a trust which it creates, does not satisfy the provisions of section 165." (R. 36.)

It then cited certain decisions which it found on its own motion as it stated neither side had been able to cite any authorities. Those decisions do not support that Court's conclusions. *In re Roche,* 126 N. Y. S. 766, simply held that a certain municipal employee did not come under the city's pension system until 1907 although prior to that time he had been employed since 1887 in a class of employees not covered by the system. *Broadhurst v. City of Fall River,* 179 N. E. 586, simply held that a retirement by the mayor of a city employee did not entitle him to a pension until approval by the city's Board of Finance. *Commissioner v. Buck,* 120 F.2d 775, and *Stockstrom v. Commissioner,* 151 F.2d 353 (erroneously given in the opinion as page 253), involved solely whether a grantor-trustee had reserved such control over a trust that the income therefrom should be taxable to him under the doctrine of *Helvering v. Clifford,* 309 U. S. 331. We cannot see their relevancy to this case.

The Congress in its many Revenue Acts has never used the term "reasonable pension plan," but has always in Section 23(p) used "pension trust to provide for the payment of reasonable pensions." When it ceased to use that term in the Revenue Act of 1942, it still did not use the term "reasonable plan" but in Sections 23(p) and 165 laid out detailed specifications that a plan must meet. It was a relatively simple matter for an employer to determine whether

the amount of pensions to be paid would be reasonable, but if Congress had used the term "reasonable plan" without setting out any specific tests, as it did in 1942, no employer could ever know whether a plan met the requirements of the Code or not. Even in the light of the opinions of the two lower courts in this case, no employer could determine whether a proposed plan would be a "reasonable plan." We submit that such a test is wholly unauthorized under the plain provisions of the Internal Revenue Code.

We desire a brief word concerning the statements of The Tax Court that this was a mere device by which the petitioner could dispense charity and could favor certain employees over others. Mr. Gossett, Chairman of the Board of petitioner, testified (R. 81-82) that they made a long investigation of various plans and decided upon this one which would be flexible in nature so that the Trustee could pay larger pensions to needy employees than it could if required to pay like pensions to all employees in the same circumstances regardless of their respective needs. The record showed the operation of the plan from its inception through 1943, the last year involved in this case. The record of pensions paid (Exhibit No. 7, R. 97) shows payments in 1940 through 1945 (the record for 1944 and 1945 being excluded by the court) to five employees, four of whom ranged from 57 to 80 years at the time of retirement with the fifth 44 years of age. At their retirement they were, respectively, Vice-President, Custodian of Safekeeping, employee in charge of mail, head bookkeeper and

stenographer. The financial statements of the trust fund (those for 1940 to 1942 being attached to the stipulation, R. 71-76, and those for later years having been offered as Exhibits Nos. 11, 12 and 13, R. 100-105) showed the application of all income to the payment of expenses and pensions, with any balance carried over to capital.

We see no difference between the present case where petitioner as trustee would *in the future* determine the employees to be pensioned and one in which an employer *at the time of creating a trust* would pick a few specific employees to be pensioned under the trust, and yet the courts have consistently held prior to 1942 that in the latter case the trust would be exempt. This is illustrated by the memorandum opinion of the Board of Tax Appeals in *Albert W. Harris v. Commissioner* (found in Commerce Clearing House Decision 10,864-A) decided in 1939 under the 1928 Revenue Act. Section 165 of that Act was substantially the same as it existed prior to the slight revision in 1938, and was substantially the same as in the 1936 Act set out above in this brief. That section stated the requirements to be met by a pension trust to be exempt, and then provided that no beneficiary should be taxable in any year in which an employer made a contribution to an exempt trust on account of his part of such contribution but should be taxable only as and when he received a distribution from the trust. The Harris Bank and an associated company, the N. W. Harris Company, created a trust with three officers of the Bank as Trustees. The Bank and the

Company at the end of each year would make contributions to the trust for the payment of pensions to such of the executive officers only whom they designated at the time of each contribution. The case involved an attempt by the Government to tax the beneficiary officers upon their interest in the annual contributions on the theory that the trust was not exempt under Section 165. The Board of Tax Appeals in rejecting this argument of the Government said:

> "It is the contention of the respondent herein that the Benefit Fund was not created for the exclusive benefit of the employees but, on the contrary, was created for the benefit of a few executive officers of the Bank to the specific exclusion of the employees.
>
> "It should be noted that it is not necessary that a pension trust be organized for the benefit of all of the employees of an employer in order to qualify as an 'Employees' Trust' under section 165 of the statute. If the trust is created for the exclusive benefit of *some of the employees* the requirements of the statute are satisfied. There is no merit in the respondent's contention that officers may not be employees. They clearly may be, and in many cases are. Because an employee is an officer of a corporation does not deprive him of the right to be classed as an employee.
>
> "Nor is there any merit in the respondent's contention that the Benefit Fund was not created for the *exclusive benefit* of employees of the Harris Bank and of The N. W. Harris Co. The Benefit Fund was created for the exclusive benefit of the senior executives of the Harris Bank. Upon the payment into the Benefit Fund by the

> Harris Bank and by The N. W. Harris Co. the payors lost all right to the moneys paid. Thus, the moneys became the exclusive property of the Trustees of the Benefit Fund to be administered for the benefit of the employees."

In reference to the treatment of the trust itself by the Government, the Board said:

> "The respondent was familiar with the trust agreement and the administration of the Benefit Fund and, conformably with administrative interpretation, treated it as an employees' trust under section 165 of the Revenue Act of 1928 and corresponding provisions of prior acts."

The only difference between that case and the present one is that there the employees were picked from the executive officers of the Bank and designated by it each year whenever a contribution was made, while in this case pensions may be paid to any employee and those to receive pensions are designated from time to time by the petitioner acting as Trustee of the trust fund.

We submit that the construction placed upon the Internal Revenue Code by the lower courts is erroneous.

Point B

The respondent throughout has contended that the trust failed to meet the requirements of Section 165 that the trust fund must be for the exclusive benefit of the employees, on the very tenuous argument that the trustee, through its authority to designate what

employees would receive pensions, could play one group against another and thereby obtain a greater loyalty to petitioner from the favored group. With the possibility in mind that the Tax Court might be influenced by this actually insupportable argument, the petitioner offered evidence of the actual operations of the trust fund not only for the years involved, 1940, 1941 and 1942, but also for the subsequent years down to the trial of the case. Mr. Gossett testified that petitioner knew no groups of employees as separate groups, that there had been no shifting of funds of the trust between groups or shifting of funds in any respect, and that, after a copy of the pension trust was given to all employees in 1940 upon its creation, nothing more was said to them and no effort was made to call it to the attention of new employees. (R. 82-84.) In petitioner's exhibit No. 7 (R. 97) it showed all of the employees that had received pensions since the beginning of the trust, consisting of a Vice-President, a Custodian of Safekeeping, an employee in charge of mail, a head bookkeeper, and a stenographer, with salaries ranging from $675 down to $166.83. Petitioner then offered its Exhibits 8, 9 and 10 showing the average number of employees, the number 60 years old or over, its capital, surplus and undivided profits, total salaries paid and salaries paid to the highest 10 employees (R. 98-99). Those exhibits in so far as they related to the years after 1942 were excluded (R. 85-86). Petitioner then offered exhibits Nos. 11, 12 and 13 (R. 100-105), showing the financial operations of the

pension trust for each of the years after 1942, which were excluded (R. 86). These financial statements showed the nature of the investment of the trust fund, the expenses, the income and the amount paid out in pensions. Any amount not paid out in pensions was added to the trust fund.

This evidence showed the use of the trust fund solely for the employees, and if the argument by the Government were at all tenable, then this evidence was pertinent and error was committed in excluding it.

Conclusion

It is respectfully submitted that this case is such as to call for the exercise by this Court of its supervisory powers and we, therefore, respectfully pray that the petition for writ of certiorari to the United States Circuit Court of Appeals for the Fifth Circuit be granted.

HOMER L. BRUCE
Attorney for Petitioner

APPENDIX A

Treasury Regulations 103, Promulgated Under the Internal Revenue Code in Effect in 1940 and prior to the Revenue Act of 1942

SEC. 19.23 (p)-1. *Payments to employees' pension trusts.*—An employer who adopts or has adopted a reasonable pension plan, actuarially sound, and who establishes, or has established, and maintains a pension trust for the payment of reasonable pensions to his employees (if the trust is exempt from tax under section 165, relating to trusts created for the exclusive benefit of employees) shall be allowed to deduct from gross income reasonable amounts paid to such trust, in accordance with the pension plan (including any reasonable amendment thereof) as follows:

(a) If the plan contemplates the payment to the trust, in advance of time when pensions are granted, of amounts to provide for future pension payments, then (1) reasonable amounts paid to the trust during the taxable year representing the pension liability applicable to such year, determined in accordance with the plan, shall be allowed as a deduction for such year as an ordinary and necessary business expense, and in addition (2) one-tenth of a reasonable amount transferred or paid to the trust during the taxable year to cover in whole or in part the pension liability applicable to the years prior to the taxable year, or so transferred or paid to place the trust on a sound financial basis, shall be allowed as a deduction for the taxable year and for each of the nine succeeding taxable years.

(b) If the plan does not contemplate the payment to the trust, in advance of the time when pensions are granted, of amounts to provide for future pension payments, then (1) reasonable amounts paid to the

trust during the taxable year representing the present value of the expected future payments in respect of pensions granted to employees retired during the taxable year shall be allowed as a deduction for such year as an ordinary and necessary business expense, and in addition (2) one-tenth of a reasonable amount transferred or paid to the trust during the taxable year to cover in whole or in part the present value of the expected future payments in respect of pensions granted to employees retired prior to the taxable year, or so transferred or paid to place the trust on a sound financial basis, shall be allowed as a deduction for the taxable year and for each of the nine succeeding taxable years.

Deductions under section 23 (p) of the Internal Revenue Code or under a similar section of a prior Revenue Act and apportioned to any taxable year beginning after December 31, 1937, shall be allowable only with respect to a taxable year (whether the year of the transfer or payments or a subsequent year) of the employer which ends with or within a taxable year of the trust with respect to which the trust is exempt from tax under section 165. As to what constitutes an exempt employees' trust, see section 19.165-1.

If any portion of the funds of an exempt pension trust reverts to the possession, ownership, or control of the employer by reason of the termination of the trust or otherwise, such amount (except to the extent that it represents a payment to the pension trust made by the employer in accordance with the pension plan and pursuant to the first paragraph of this section, and not theretofore allowed as a deduction to the employer) shall be returned as income by the employer for the taxable year in which it so reverts, unless prior to the close of such year it shall again be placed in trust for the benefit of employees under provisions satisfactory to the Commissioner.

Reasonable payments made by an employer during the taxable year directly to pensioners on account of pensions in respect of which no payment has been made to a pension trust shall be allowed as a deduction from gross income for such year as an ordinary and necessary business expense.

In no case will any amount be allowed as a deduction under section 23 (p) and this section for the taxable year which was allowable as a deduction from gross income for any prior taxable year.

* * * * *

SEC. 19.23 (p)-2. *Information to be furnished by employer claiming deductions.*—If a deduction from gross income is claimed under section 23 (p) in an income return or in a claim for refund on account of payments to an employees' pension trust, the employer shall file with such return or claim for refund a statement describing the pension trust plan, including the basis and method of its operation, together with a copy of the trust indenture, with any amendments thereto, and other documents constituting a part of the plan. If all employees are not included as beneficiaries of the pension trust, a statement showing what classes of employees are excluded, and the general nature of their respective employment and duties, together with the reason why all employees are not covered by the pension trust plan, shall likewise be filed. If such statements have once been filed and if the return contains a statement when and where such statements were filed, they need not again be filed; but, however, if changes in the pension trust plan have been made, a statement showing the nature of such changes (together with copies of any amendments to the trust indenture and other documents constituting a part of the plan) must be filed with the return for the first taxable year for which allowance of deductions under section 23 (p)

may be affected by such changes in the pension trust plan.

In addition the following described data and information shall be kept at all times available for inspection by internal revenue officers at the main office or principal place of business of the employer:

1. Schedules of work sheets showing the derivation of the basic valuation factors, or, if such data are not available, a statement giving the source of the factors from which the actuarial valuations were made.

2. (a) Schedules showing the computation of the reserve liability for all employees in the active service as determined from the most recent actuarial valuation. For the taxable years beginning after December 31, 1938, the most recent actuarial valuation, for the purposes of this section, means such a valuation made not earlier than five years prior to the filing of the return.

(b) A similar schedule based on the next preceding valuation if such a valuation has been made.

3. A schedule showing by ages the individual current liability factors and the application of these factors in determining the liability accrued during the current taxable year.

4. (a) A schedule showing the computation of the pension liability for all employees retired on pension at the date of the last actuarial valuation.

(b) A schedule showing, by calendar years, the present value of pensions granted from the date of the last actuarial valuation to the end of the taxable year for which the deduction is claimed in an income return or in a claim for refund.

5. A schedule showing the receipts and disbursements of the pension fund during each taxable year

carried forward from the date the pension trust was established. The receipts should include the accruals mentioned in 3 above, interest, and any other moneys credited to the fund. The disbursements should include actual pension payments made to retired employees and any other expenditures charged to the pension fund.

If the valuation factors are changed at any time, either because of a change in the pension plan or because of a change in the assumptions upon which the valuation factors are based, the data indicated under 2, 3, and 4 above should be available showing the application of both the old and the new valuation factors to the pay roll as of the valuation date coinciding with or next following the date of the change.

If the pension plan does not contemplate the payment to the trust in advance of the time when pensions are granted, of amounts to provide for future pension payments, the data described under 2 and 3 above need not be furnished.

SEC. 19.165-1 (as amended by T. D. 4973, 1940-1 Cum. Bull. 65). *Employees' trusts.*—(a) *Plans and trusts for employees.*—A "stock bonus, pension, or profit-sharing plan of an employer for the exclusive benefit of some or all of his employees" is a definite written program and arrangement communicated to such employees, solely designed and applied to enable such employees to share in the capital or profits of such employer's trade or business or to provide for the livelihood of such employees upon their retirement from employment. A "trust forming part of a stock bonus, pension, or profit-sharing plan" is a trust formed and availed of solely to aid in the proper execution of one of the plans defined in the preceding sentence. This phrase includes only trusts created for the exclusive benefit of employees, and does not include devices for distributing profits to share-

holders. All the surrounding and attending circumstances and the details of the plan will be indicative of whether it is a bona fide stock bonus, pension, or profit-sharing plan for the exclusive benefit of employees within the meaning of Section 165.

(b) *Taxable years beginning prior to January* 1, 1940.—A trust forming part of a plan defined in paragraph (a) is exempt for taxable years beginning prior to January 1, 1940, if: (1) contributions are made to the trust by such employer, such employees, or both; and (2) such contributions are made for the purpose of distributing to such employees both the earnings and principal of the fund accumulated by the trust; and (3) the fund is accumulated by the trust in accordance with the plan of which the trust is a part.

(c) *Taxable years beginning after December* 31, 1939.—A trust forming part of a plan defined in paragraph (a) is exempt for taxable years beginning after December 31, 1939, if all three tests designated in paragraph (b) as (1), (2), and (3) are met; and if also (4) the trust instrument makes it impossible (in the taxable year and at any time thereafter prior to the satisfaction of all liabilities to employees covered by the trust) for any part of the trust corpus or income to be used for, or diverted to, purposes other than for the exclusive benefit of such employees.

(d) *Impossibility of diversion.*—As used in section 165 (a) (2), the phrase "if under the trust instrument it is impossible" means that the trust instrument must definitely and affirmatively make it impossible for the non-exempt diversion or use to occur, whether by operation or natural termination of the trust, by power of revocation or amendment, by the happening of a contingency, by collateral arrangement, or by any other means. It is not essential that the employer relinquish all power to modify or terminate the rights of certain employees covered by the

trust, but except as stated in paragraph (e), it must be impossible for trust funds to be used or diverted for purposes other than for the exclusive benefit of his employees. The diversion of substantial amounts of trust funds from one group of employees to another group of employees is not for the "exclusive" benefit of employees even though both groups were covered by the trust, if the employer (or other non-employee) receives substantial indirect benefit thereby, as, for example, through securing greater loyalty from the favored group, or through the shifting of expected pension benefits to a younger group and the postponement of part of the employer's contributions to a later date. As used in section 165 (a) (2), the phrase "purposes other than for the exclusive benefit of his employees" includes all objects or aims not solely designed for the proper satisfaction of all liabilities to employees covered by the trust.

(e) *Meaning of "liabilities."*—The report of the Senate Committee on Finance on the Revenue Act of 1938 states that the intent and purpose in section 165 (a) (2) thereof (which is identical to section 165 (a) (2) of the Internal Revenue Code) of the phrase "prior to the satisfaction of all liabilities with respect to employees under the trust" is to permit the employer to reserve the right to recover only such balance in the trust at its termination as is "due to erroneous actuarial computations during the previous life of the trust." An "erroneous actuarial computation" means a mistake of an actuarial character reasonably made by a careful person skilled in calculating the amount necessary to satisfy pecuniary obligations depending on the average length of life of a group of individuals, and of such a type that the employer may reserve the right to recover an amount remaining in the trust because of the mistake without conflicting with the purpose for which section 165 (a) (2) was enacted. For example, if a trust created to supply pensions of $25 a month for 10,000 em-

ployees for the remainder of their lives after age 60 has been used to supply such pensions only to 500 employees, an amount remaining in the trust for this reason is not due to such a mistake, but to a change in plan; while if $25 a month after age 60 is paid to the 10,000 employees during their lives, but their average duration of life proves less than might reasonably have been expected, an amount remaining in the trust for this reason is due to an "erroneous actuarial computation." Employers might recover more than amounts resulting from such errors if the term "liabilities" included only such obligations to employees as are legally fixed and certain. Hence, the term was used in the Internal Revenue Code in its broad common meaning to include both fixed and contingent obligations to employees. For example, if 1,000 employees are covered by a trust forming part of a pension plan, 300 of whom have satisfied all the requirements for a monthly pension, while the remaining 700 employees have not yet completed the required period of service, contingent obligations to such 700 employees had nevertheless arisen which constitute "liabilities" within the meaning of that term. It must be impossible for the employer (or other non-employee) to recover other than such amounts as remain in the trust because of "erroneous actuarial computations" after the satisfaction of all such fixed and contingent obligations, and the trust instrument must contain a definite affirmative provision to that effect whether the obligations to employees have their source in the trust instrument itself, in the plan of which the trust forms a part, or in some collateral instrument or arrangement forming a part of such plan, and whether such obligations are, technically speaking, liabilities of the employer, of the trust, or of some other person forming a part of the plan or connected with it.

* * * * *

(g) *Proof of exemption.*—Every trust claiming exemption must prove its right thereto by filing with the collector: (1) an affidavit showing its character, purpose, activities, sources and disposition of corpus and income, and every fact which might affect its status for exemption, (2) verified copies of the trust instrument and of the employer's plan, showing all amendments, and (3) the latest financial statement, showing the assets, liabilities, receipts, and disbursements of the trust. The financial statement must be filed each year, but the documents mentioned in (1) and (2) need not be filed after the first year except when necessary to show changes occurring since the last filing.

APPENDIX B

Sections 23(p) and 165 of the Internal Revenue Code as amended by the Revenue Act of 1942

Sec. 23. In computing net income there shall be allowed as deductions:

(p) CONTRIBUTIONS OF AN EMPLOYER TO AN EMPLOYEES' TRUST OR ANNUITY PLAN AND COMPENSATION UNDER A DEFERRED-PAYMENT PLAN.—

(1) GENERAL RULE.—If contributions are paid by an employer to or under a stock bonus, pension, profit-sharing, or annuity plan, or if compensation is paid or accrued on account of any employee under a plan deferring the receipt of such compensation, such contributions or compensation shall not be deductible under subsection (a) but shall be deductible, if deductible under subsection (a) without regard to this subsection, under this subsection but only to the following extent:

(A) In the taxable year when paid, if

the contributions are paid into a pension trust, and if such taxable year ends within or with a taxable year of the trust for which the trust is exempt under section 165 (a), in an amount determined as follows:

(i) an amount not in excess of 5 per centum of the compensation otherwise paid or accrued during the taxable year to all the employees under the trust, but such amount may be reduced for future years if found by the Commissioner upon periodical examinations at not less than five-year intervals to be more than the amount reasonably necessary to provide the remaining unfunded cost of past and current service credits of all employees under the plan, plus

(ii) any excess over the amount allowable under clause (i) necessary to provide with respect to all of the employees under the trust the remaining unfunded cost of their past and current service credits distributed as a level amount, or a level percentage of compensation, over the remaining future service of each such employee, as determined under regulations prescribed by the Commissioner with the approval of the Secretary, but if such remaining unfunded cost with respect to any three individuals is more than 50 per centum of such remaining unfunded cost, the amount of such unfunded cost attributable to such individuals shall be distributed over a period of at least 5 taxable years, or

(iii) in lieu of the amounts allowable under (i) and (ii) above, an amount

equal to the normal cost of the plan, as determined under regulations prescribed by the Commissioner with the approval of the Secretary, plus, if past service or other supplementary pension or annuity credits are provided by the plan, an amount not in excess of 10 per centum of the cost which would be required to completely fund or purchase such pension or annuity credits as of the date when they are included in the plan, as determined under regulations prescribed by the Commissioner with the approval of the Secretary, except that in no case shall a deduction be allowed for any amount (other than the normal cost) paid in after such pension or annuity credits are completely funded or purchased.

(iv) Any amount paid in a taxable year in excess of the amount deductible in such year under the foregoing limitations shall be deductible in the succeeding taxable years in order of time to the extent of the difference between the amount paid and deductible in each such succeeding year and the maximum amount deductible for such year in accordance with the foregoing limitations.

(B) In the taxable year when paid, in an amount determined in accordance with subparagraph (A) of this paragraph, if the contributions are paid toward the purchase of retirement annuities and such purchase is a part of a plan which meets the requirements of section 165 (a), (3), (4), (5), and (6), and if refunds of premiums, if any, are ap-

plied within the current taxable year or next succeeding taxable year towards the purchase of such retirement annuities.

(C) In the taxable year when paid, if the contributions are paid into a stock bonus or profit-sharing trust, and if such taxable year ends within or with a taxable year of the trust with respect to which the trust is exempt under section 165 (a), in an amount not in excess of 15 per centum of the compensation otherwise paid or accrued during the taxable year to all employees under the stock bonus or profit-sharing plan. If in any taxable year beginning after December 31, 1941, there is paid into the trust, or a similar trust then in effect, amounts less than the amounts deductible under the preceding sentence, the excess, or if no amount is paid, the amounts deductible, shall be carried forward and be deductible when paid in the succeeding taxable years in order of time, but the amount so deductible under this sentence in any such succeeding taxable year shall not exceed 15 per centum of the compensation otherwise paid or accrued during such succeeding taxable year to the beneficiaries under the plan. In addition, any amount paid into the trust in a taxable year beginning after December 31, 1941, in excess of the amount allowable with respect to such year under the preceding provisions of this subparagraph shall be deductible in the succeeding taxable years in order of time, but the amount so deductible under this sentence in any one such succeeding taxable year together with the amount allowable under the first sentence of this subparagraph shall not exceed 15 per centum of the compensation otherwise paid or accrued during such tax-

able year to the beneficiaries under the plan. The term "stock bonus or profit-sharing trust," as used in this subparagraph, shall not include any trust designed to provide benefits upon retirement and covering a period of years, if under the plan the amounts to be contributed by the employer can be determined actuarially as provided in subparagraph (A). If the contributions are made to two or more stock bonus or profit-sharing trusts, such trusts shall be considered a single trust for the purposes of applying the limitations in this subparagraph.

(D) In the taxable year when paid, if the plan is not one included in paragraphs (A), (B), or (C), if the employees' rights to or derived from such employer's contribution or such compensation are nonforfeitable at the time the contribution or compensation is paid.

(E) For the purposes of subparagraphs (A), (B), and (C), a taxpayer on the accrual basis shall be deemed to have made a payment on the last day of the year of accrual if the payment is on account of such taxable year and is made within sixty days after the close of the taxable year of accrual.

(F) If amounts are deductible under subparagraphs (A) and (C), or (B) and (C), or (A), (B), and (C), in connection with two or more trusts, or one or more trusts and an annuity plan, the total amount deductible in a taxable year under such trusts and plans shall not exceed 25 per centum of the compensation otherwise paid or accrued during the taxable year to the persons who are the beneficiaries of the trusts or plans.

In addition, any amount paid into such trust or under such annuity plans in a taxable year beginning after December 31, 1941, in excess of the amount allowable with respect to such year under the preceding provisions of this subparagraph shall be deductible in the succeeding taxable years in order of time, but the amount so deductible under this sentence in any one such succeeding taxable year together with the amount allowable under the first sentence of this subparagraph shall not exceed 30 per centum of the compensation otherwise paid or accrued during such taxable years to the beneficiaries under the trusts or plans. This subparagraph shall not have the effect of reducing the amount otherwise deductible under subparagraphs (A), (B), and (C), if no employee is a beneficiary under more than one trust, or a trust and an annuity plan.

If there is no plan but a method of employer contributions or compensation has the effect of a stock bonus, pension, profit-sharing, or annuity plan, or similar plan deferring the receipt of compensation, this paragraph shall apply as if there were such a plan.

(2) DEDUCTIONS UNDER PRIOR INCOME TAX ACTS. —Any deduction allowable under section 23 (q) of the Revenue Act of 1928 (45 Stat. 802), or the Revenue Act of 1932 (47 Stat. 182), or the Revenue Act of 1934 (48 Stat. 691), under section 23 (p) of the Revenue Act of 1936 (49. Stat. 1661), or the Revenue Act of 1938 (52 Stat. 464), or the Internal Revenue Code for a taxable year beginning before January 1, 1943, which under such section was apportioned to any taxable year beginning after December 31, 1942, shall be

allowed as a deduction for the years to which so apportioned to the extent allowable under such section if it had remained in force with respect to such year.

Sec. 165. (a) EXEMPTION FROM TAX.—A trust forming part of a stock bonus, pension, or profit-sharing plan of an employer for the exclusive benefit of his employees or their beneficiaries shall not be taxable under this supplement and no other provision of this supplement shall apply with respect to such trust or to its beneficiary—

(1) if contributions are made to the trust by such employer, or employees, or both, for the purpose of distributing to such employees or their beneficiaries the corpus and income of the fund accumulated by the trust in accordance with such plan;

(2) if under the trust instrument it is impossible, at any time prior to the satisfaction of all liabilities with respect to employees and their beneficiaries under the trust, for any part of the corpus or income to be (within the taxable year or thereafter) used for, or diverted to, purposes other than for the exclusive benefit of his employees or their beneficiaries;

(3) if the trust, or two or more trusts, or the trust or trusts and annuity plan or plans are designated by the employer as constituting parts of a plan intended to qualify under this subsection which benefits either—

(A) 70 per centum or more of all the employees, or 80 per centum or more of all the employees who are eligible to benefit under the plan if 70 per centum or more of all the employees are eligible to benefit under the plan, excluding in each case employees who

have been employed not more than a minimum period prescribed by the plan, not exceeding five years, employees whose customary employment is for not more than twenty hours in any one week, and employees whose customary employment is for not more than five months in any calendar year, or

(B) such employees as qualify under a classification set up by the employer and found by the Commissioner not to be discriminatory in favor of employees who are officers, shareholders, persons whose principal duties consist in supervising the work of other employees, or highly compensated employees;

and

(4) if the contributions or benefits provided under the plan do not discriminate in favor of employees who are officers, shareholders, persons whose principal duties consist in supervising the work of other employees, or highly compensated employees.

(5) A classification shall not be considered discriminatory within the meaning of paragraphs (3)(B) or (4) of this subsection merely because it excludes employees the whole of whose remuneration constitutes "wages" under section 1426(a)(1) (relating to the Federal Insurance Contributions Act) or merely because it is limited to salaried or clerical employees. Neither shall a plan be considered discriminatory within the meaning of such provisions merely because the contributions or benefits of or on behalf of the employees under the plan bear a uniform relationship to the total compensation, or the basic or regular rate of compensation, of such em-

ployees, or merely because the contributions or benefits based on that part of an employee's remuneration which is excluded from "wages" by section 1426(a)(1) differ from the contributions or benefits based on employee's remuneration not so excluded, or differ because of any retirement benefits created under State or Federal law.

(6) A plan shall be considered as meeting the requirements of paragraph (3) of this subsection during the whole of any taxable year of the plan if on one day in each quarter it satisfied such requirements.

(b) TAXABILITY OF BENEFICIARY.—The amount actually contributed or made available to any distributee by any such trust shall be taxable to him, in the year in which so distributed or made available, under section 22(b)(2) as if it were an annuity the consideration for which is the amount contributed by the employee, except that if the total distributions payable with respect to any employee are paid to the distributee within one taxable year of the distributee on account of the employee's separation from the service, the amount of such distribution to the extent exceeding the amounts contributed by the employee, shall be considered a gain from the sale or exchange of a capital asset held for more than 6 months.

(c) TREATMENT OF BENEFICIARY OF TRUST NOT EXEMPT UNDER SUBSECTION (a).—Contributions to a trust made by an employer during a taxable year of the employer which ends within or with a taxable year of the trust for which the trust is not exempt under section 165(a) shall be included in the gross income of an employee for the taxable year in which the contribution is made to the trust in the case of an employee whose beneficial interest in such contribution is nonforfeitable at the time the contribution is made.

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760245—47——1

In the Supreme Court of the United States

OCTOBER TERM, 1947

No. 273

SOUTH TEXAS COMMERCIAL NATIONAL BANK OF HOUSTON, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the Tax Court (R. 30–37) is reported at 7 T. C. 764. The opinion of the Circuit Court of Appeals (R. 109–111) is not yet reported.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on June 25, 1947 (R. 111–112). The petition for a writ of certiorari was filed on August 16, 1947. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether the so-called "pension" trust, to which the taxpayer made transfers in the taxable years, was part of a pension "plan" to provide for the payment of reasonable "pensions", so as to be an exempt trust within the meaning of Section 165 of the Internal Revenue Code, and to permit the taxpayer to deduct in the taxable years, under Section 23 (p) of the Code, percentages of the amounts transferred.

STATUTES AND REGULATIONS INVOLVED

The applicable statutes and regulations are printed in the Appendix, *infra*, pp. 13–22.

STATEMENT

The facts found by the Tax Court (R. 31–33) may be summarized as follows:

On January 9, 1940, the taxpayer, a national bank with principal place of business at Houston, Texas, established a trust which it designated an "Employees' Pension Trust," by an instrument executed by itself in its corporate individual capacity to itself as trustee. The trust agreement provided that the trust estate should consist of the sum of $85,000 but that the taxpayer might in the future make further contributions to the estate, without, however, being under any obligation to do so (R. 31).

The trustee was authorized, out of the income or, if necessary, the corpus of the trust estate, to

pay to the present and future officers and employees of the taxpayer pensions in such amounts and at such times as the trustee in its absolute, uncontrolled discretion might determine. The trustee could select the retired employees to receive these payments, the amount which each individual should receive, and the trustee could at any time reduce or discontinue entirely any payments to any beneficiary. Its powers in this respect were the same as "if the trustee were an individual person and the actual owner thereof." However, the trustee was controlled in its discretion by the board of directors and the trust committee of the taxpayer (R. 31–32).

No beneficiary of the trust made any contribution to the trust fund, nor did such beneficiaries have any contractual or legal rights in the fund whatsoever (R. 32).

The trust was declared to be irrevocable, to continue until final distribution of the entire trust estate. In the event of the dissolution of the taxpayer, the trustee was authorized and directed to distribute the corpus of the trust among the beneficiaries in whatever amounts and to whatever individuals the trustee chose to extend its bounty (R. 32).

The taxpayer, as trustor, reserved the right to amend the trust agreement in any manner considered desirable to procure a more advantageous administration and a more efficient accomplishment of the purposes of the trust, with the single

limitation that no part of the trust estate, either corpus or accumulated income, could be diverted to any purpose other than the one set forth in the trust agreement (R. 32).

At the time the trust was created, a copy of the agreement was printed in pamphlet form and distributed to the employees and thereafter no communication was made by the taxpayer, either individually or as trustee, to its employees relative to the "pension plan." If new employees were informed as to the pension plan, it was not done officially, either by the taxpayer as trustor or trustee (R. 32–33).

Taxpayer paid into the trust $150,000 in 1940, $85,000 in 1941, and $165,000 in 1942, and deducted from its income in 1940, $15,000, or ten percent of the $150,000 contributed to the trust. In 1941 it deducted $23,500 or ten percent of the total amount it had contributed to the trust in 1940 and 1941. In 1942 it deducted $40,000, being ten percent of the amount of all prior contributions. The trustee paid out of the trust fund certain amounts to its retired employees according to the discretion of the trustee during the years involved here (R. 33).

Upon these facts, the Tax Court held that the taxpayer was not entitled to the deductions claimed in the taxable years under Section 23 (p) of the Internal Revenue Code (R. 33–37) and the Circuit Court of Appeals affirmed (R. 109–111).

ARGUMENT

The judgment of the lower court is not in conflict with any decision and is correct.

In order for the taxpayer to be entitled to deduct from its income percentages of the amounts transferred by it in the taxable years to its employees' trust under Section 23 (p) of the Internal Revenue Code as it stood before its amendment in 1942 (Appendix, *infra,* p. 13, and see *infra,* p. 11), the trust must be a "pension trust to provide for the payment of reasonable pensions" to its employees (Sec. 23 (p) (1)), and the trust must form "part of a * * * pension * * * plan * * * for the exclusive benefit of some or all" of its employees (Sec. 165, Internal Revenue Code;[1] Appendix, *infra,* p. 14).

These statutory provisions, at the very least, connote a sound plan under which those eligible for, and the amounts of, the pensions to be paid, are determined by a consistent and reasonable method, bearing a relation to the salary earned, the length of service, and the age of the recipient.[2]

[1] Section 23 (p) (3) of the Code conditions the allowance of the deductions upon the retirement that the trust shall conform to the specifications of Section 165.

[2] In connection with the amendments made to Sections 23 (p) and 165 by Section 162 of the Revenue Act of 1942, c. 619, 56 Stat. 798, see *infra,* p. 11, H. Rep. No. 2333, 77th Cong., 2d Sess., pp. 50–51 (1942–2 Cum. Bull. 372), states:

"The present law endeavors to encourage the setting up of retirement benefits by employers for their employees and in

Cf. 4 Mertens, *Law of Federal Income Taxation* (1942), Sec. 25.74. Further, however, the legislative history shows that the sort of pension plan contemplated by the statutory provisions was one having an actuarial basis. Section 23 (p) of the Code originated in substantially the same form as Section 23 (q) of the Revenue Act of 1928, c. 852, 45 Stat. 791, and in connection therewith, H. Conference Rep. No. 1882, 70th Cong., 1st Sess., p. 12 (1939–1 Cum. Bull. (Part 2) 444, 445–446), explained that the deduction was permitted, upon the creation of a pension trust, "to build up reserves in order to place the plan upon a basis which is actuarily sound". S. Rep. No. 1567, 75th Cong., 3d Sess., p. 24 (1939–1 Cum. Bull. (Part 2) 779, 796), again indicated, in connection with an amendment of Section 165 by the Revenue Act of 1938, c. 289, 52 Stat. 447, that the type of pension trust contemplated by the statute is one resting on actuarial computations. The

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pursuance of this policy permits employers to take as a deduction amounts irrevocably set aside in a pension trust or other fund to provide annuities or retirement benefits for superannuated employees. This provision has been considerably abused by the use of discriminatory plans which either cover only a small percentage of the employees or else favor the higher paid or stock-holding employees as against the lower-paid or non-stock-holding employees. Under the present law, it is contended the officers of a corporation may set up pension plans for themselves and make no provision for the other employees. Such actions are not in keeping with the purpose of this provision."

legislative purpose in this respect is specifically implemented by the administrative regulations. Section 19.23 (p)–1 of Treasury Regulations 103 (Appendix, *infra*, pp. 14–16), continuing a provision first contained in Article 271 of Treasury Regulations 74,[3] promulgated under the Revenue Act of 1928, requires that the trust must operate on a plan for pensions which is actuarially sound, and Section 19.23 (p)–2 (Appendix, *infra*, pp. 16–19) prescribes the maintenance of information with respect to actuarial valuations for reserves. And cf. Section 19.165–1 (e) of Treasury Regulations 103 (Appendix, *infra*, pp. 20–22).

The Tax Court found (R. 34–37) that the arrangement in this case does not have sufficient definiteness to be a "plan", nor are the payments made and to be made from the fund "pensions" within the meaning of the statute. The Circuit Court of Appeals agreed with these findings (R. 111), and the facts fully support them, if they do not compel them. No employee had any rights of any kind with respect to receipt of benefits. The taxpayer under the trust retained the absolute and uncontrolled power to select the employee beneficiaries of the fund, no standards

[3] The long-standing regulation is thus deemed to have Congressional approval and the effect of law. *Crane* v. *Commissioner*, No. 68, Oct. Term, 1946, decided by this Court on April 14, 1947; *Helvering* v. *Winmill*, 305 U. S. 79, 83.

whatever for eligibility being established,[4] to determine if, when, and how long payments to any chosen beneficiary would be made, and to decide how much would be paid to each designated beneficiary, irrespective of his age, length of service, or former salary, subject only to the limitation that the monthly payment could not exceed $250 or be less than $25. The trust did not contemplate payments on an actuarial basis and the fund was not based on actuarial computations or liabilities. (R. 58, 65.)

There is no merit to the contention (Pet. 6–7) that both lower courts erroneously applied the statute, on the theory that the statute requires at most a plan to pay "reasonable pensions". On the Tax Court's findings, which were completely justified and were affirmed, the taxpayer did not have a "plan" to pay "pensions" at all, much less one to pay "reasonable pensions", and thus it is necessarily excluded from the scope of the statute under its own literal construction thereof. The taxpayer points to no circumstances which would compel the conclusion that its trust established a pension plan in a real and substantial sense.

Nor is there merit to the taxpayer's argument that its "plan" was in fact actuarially sound

[4] There was testimony that the intention was to pay amounts on the basis of financial need (R. 82), but the trust provisions do not provide that needy employees shall be eligible, nor do they erect any standards for determination of the amounts payable to this class of employees, if any.

because it as trustee would pay only such pensions as the fund would bear (Pet. 20–21). As a result of its control over the payments to be made, the taxpayer could of course stop payments in order to maintain the solvency of the fund, but the term "actuarially sound", within its ordinary connotation and as detailed in Sections 19.23 (p) (2) and 19.165–1 (e) of Treasury Regulations 103, requires more than the probability of future solvency to be achieved through discontinuance of "pension" payments to the extent necessary to maintain solvency. As the taxpayer itself has stated (R. 65), "this pension trust is not based upon any actuarial computations or liabilities", and its trust thus fails to comply with the statute and the regulations.

The circumstances that the trust was for the benefit of "some" undetermined and undeterminable persons among the taxpayer's employees (Pet. 7) is not alone sufficient to bring it within the statute. While Section 165 of the Code refers to a plan for the exclusive benefit of "some or all" of the employees, this obviously does not mean that the future whim of the employer is to be the only standard for determining the ultimate beneficiaries, with the result that the so-called plan may be operated to favor only one or a few of the employees, or even the key officers or executives.[5]

[5] *Harris* v. *Commissioner*, decided October 27, 1939, by the Board of Tax Appeals (1939 P–H B. T. A. Memorandum

Cf. *Hubbell* v. *Commissioner*, 3 T. C. 626, affirmed 150 F. 2d 516 (C. C. A. 6th). Plainly, the statute contemplates that a plan for "some" of the employees will erect reasonable and nondiscriminatory standards under which those of the employees benefited will be determined. This is confirmed by Section 19.165–1 of Treasury Regulations 103, which prescribes *inter alia* that the pension plan shall be a definite written program communicated to the employees benefited.

There is a further reason why the taxpayer's trust fails to satisfy the provisions of Section 165. As Section 19.165–1 (d) of Treasury Regulations 103 points out, where the employer is in a position to secure indirect benefits in dispensing the fund, it is not, as Section 165 (2) of the Code prescribes that it shall be, impossible for the fund or its income to be diverted to uses other than for the exclusive benefit of employees. The Tax Court seems to have based its decision in part on the fact that the trust was not for the exclusive benefit of employees (R. 36), but in any case the conclusion is compelled that the trust was not one exclusively for their benefit within the meaning of Section 165 (2) and the regulation. Even though the taxpayer can not retake any of the trust property directly (R. 25), it plainly is in a position to derive substantial indirect benefits

Decisions, ¶ 39,472), asserted to be in conflict on this point (Pet. 7, 24–26), has substantially different facts. The trust instrument there designated by name the employees benefited.

because of its complete power to administer and spend the fund and to select the persons to be benefited.[6] Cf. *Stockstrom* v. *Commissioner*, 148 F. 2d 491 (C. C. A. 8th), certiorari denied, 326 U. S. 719; *Stockstrom* v. *Commissioner*, 151 F. 2d 353 (C. C. A. 8th); *Commissioner* v. *Buck*, 120 F. 2d 775 (C. C. A. 2d). While Section 165 (2) is doubtless not concerned with the general indirect benefit which every employer who adopts a pension plan probably derives through increased employee goodwill, the potential benefits to this taxpayer made possible by its complete control over its trust are of a more direct and substantial kind and clearly preclude the trust from being considered as one for the exclusive benefit of employees.

It is to be noted that the amendments made to Sections 23(p) and 165 by Section 162 of the Revenue Act of 1942, c. 619, 56 Stat. 798, which, with respect to plans in effect on or before September 1, 1942, for most purposes became operative for the taxable years commencing after December 31, 1942, establish much more detailed conditions for the application of Sections 23 (p) and 165. Hence the decision in this case is likely to have little future importance.

[6] One illustration could be that the taxpayer might secure desired services from a person whose services were not otherwise obtainable through the promise of almost immediate retirement with maximum benefits.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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APPENDIX

Internal Revenue Code:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * * *

(p) *Pension Trusts.*—

(1) *General rule.*—An employer establishing or maintaining a pension trust to provide for the payment of reasonable pensions to his employees shall be allowed as a deduction (in addition to the contributions to such trust during the taxable year to cover the pension liability accruing during the year, allowed as a deduction under subsection (a) of this section) a reasonable amount transferred or paid into such trust during the taxable year in excess of such contributions, but only if such amount (1) has not theretofore been allowable as a deduction, and (2) is apportioned in equal parts over a period of ten consecutive years beginning with the year in which the transfer or payment is made.

* * * * *

(3) *Exemption of trusts under section 165.—The provisions of paragraphs* (1) and (2) of this subsection shall be subject to the qualification that the deduction under either paragraph shall be allowable only with respect to a taxable year (whether the year of the transfer or payment or a subsequent year) of the employer ending within or with a taxable year of the trust with respect to which the trust is exempt from tax under section 165.

(26 U. S. C. 1940 ed., Sec. 23.)

SEC. 165. EMPLOYEES' TRUSTS.

A trust forming part of a stock bonus, pension, or profit-sharing plan of an employer for the exclusive benefit of some or all of his employees—

(1) if contributions are made to the trust by such employer, or employees, or both, for the purpose of distributing to such employees the earnings and principal of the fund accumulated by the trust in accordance with such plan, and

(2) if under the trust instrument it is impossible, at any time prior to the satisfaction of all liabilities with respect to employees under the trust, for any part of the corpus or income to be (within the taxable year or thereafter) used for, or diverted to, purposes other than for the exclusive benefit of his employees,

shall not be taxable under section 161, but the amount actually distributed or made available to any distributee shall be taxable to him in the year in which so distributed or made available to the extent that it exceeds the amounts paid in by him. Such distributees shall for the purpose of the normal tax be allowed as credits against net income such part of the amount so distributed or made available as represents the items of interest specified in section 25(a).

(26 U. S. C. 1940 ed., Sec. 165.)

Treasury Regulations 103, promulgated under the Internal Revenue Code:

SEC. 19.23 (p)–1. *Payments to employees' pension trusts.*—An employer who adopts or has adopted a reasonable pension plan, actuarially sound, and who establishes, or has established, and maintains a pension trust for the payment of reasonable

pensions to his employees (if the trust is exempt from tax under section 165, relating to trusts created for the exclusive benefit of employees), shall be allowed to deduct from gross income reasonable amounts paid to such trust, in accordance with the pension plan (including any reasonable amendment thereof), as follows:

(a) If the plan contemplates the payment to the trust, in advance of the time when pensions are granted, of amounts to provide for future pension payments, then (1) reasonable amounts paid to the trust during the taxable year representing the pension liability applicable to such year, determined in accordance with the plan, shall be allowed as a deduction for such year as an ordinary and necessary business expense, and in addition (2) one-tenth of a reasonable amount transferred or paid to the trust during the taxable year to cover in whole or in part the pension liability applicable to the years prior to the taxable year, or so transferred or paid to place the trust on a sound financial basis, shall be allowed as a deduction for the taxable year and for each of the nine succeeding taxable years.

(b) If the plan does not contemplate the payment to the trust, in advance of the time when pensions are granted, of amounts to provide for future pension payments, then (1) reasonable amounts paid to the trust during the taxable year representing the present value of the expected future payments in respect of pensions granted to employees retired during the taxable year shall be allowed as a deduction for such year as an ordinary and necessary business expense, and in addition (2) one-tenth of a reasonable amount transferred or paid to

the trust during the taxable year to cover in whole or in part the present value of the expected future payments in respect of pensions granted to employees retired prior to the taxable year, or so transferred or paid to place the trust on a sound financial basis, shall be allowed as a deduction for the taxable year and for each of the nine succeeding taxable years.

* * * * *

Reasonable payments made by an employer during the taxable year directly to pensioners on account of pensions in respect of which no payment has been made to a pension trust shall be allowed as a deduction from gross income for such year as an ordinary and necessary business expense.

In no case will any amount be allowed as a deduction under section 23 (p) and this section for the taxable year which was allowable as a deduction from gross income for any prior taxable year.

* * * * *

SEC. 19.23 (p)–2. *Information to be furnished by employer claiming deductions.*— If a deduction from gross income is claimed under section 23 (p) in an income return or in a claim for refund on account of payments to an employees' pension trust, the employer shall file with such return or claim for refund a statement describing the pension trust plan, including the basis and method of its operation, together with a copy of the trust indenture, with any amendments thereto, and other documents constituting a part of the plan. If all employees are not included as beneficiaries of the pension trust, a statement showing what classes of employees are excluded, and the

general nature of their respective employment and duties, together with the reason why all employees are not covered by the pension trust plan, shall likewise be filed. If such statements have once been filed and if the return contains a statement when and where such statements were filed, they need not again be filed; but, however, if changes in the pension trust plan have been made, a statement showing the nature of such changes (together with copies of any amendments to the trust indenture and other documents constituting a part of the plan) must be filed with the return for the first taxable year for which allowance of deductions under section 23 (p) may be affected by such changes in the pension trust plan.

In addition the following described data and information shall be kept at all times available for inspection by internal revenue officers at the main office or principal place of business of the employer:

1. Schedules or work sheets showing the derivation of the basic valuation factors, or, if such data are not available, a statement giving the source of the factors from which the actuarial valuations were made.

2. (a) Schedules showing the computation of the reserve liability for all employees in the active service as determined from the most recent actuarial valuation. For taxable years beginning after December 31, 1938, the most recent actuarial valuation, for the purposes of this section, means such a valuation made not earlier than five years prior to the filing of the return.

(b) A similar schedule based on the next preceding valuation if such a valuation has been made.

3. A schedule showing by ages the individual current liability factors and the application of these factors in determining the liability accrued during the current taxable year.

4. (a) A schedule showing the computation of the pension liability for all employees retired on pension at the date of the last actuarial valuation.

(b) A schedule showing, by calendar years, the present value of pensions granted from the date of the last actuarial valuation to the end of the taxable year for which the deduction is claimed in an income return or in a claim for refund.

5. A schedule showing the recipts and disbursements of the pension fund during each taxable year carried forward from the date the pension trust was established. The receipts should include the accruals mentioned in 3 above, interest, and any other moneys credited to the fund. The disbursements should include actual pension payments made to retired employees and any other expenditures charged to the pension fund.

If the valuation factors are changed at any time, either because of a change in the pension plan or because of a change in the assumptions upon which the valuation factors are based, the data indicated under 2, 3, and 4 above should be available showing the application of both the old and the new valuation factors to the pay roll as of the valuation date coinciding with or next following the date of the change.

If the pension plan does not contemplate the payment to the trust in advance of the time when pensions are granted, of amounts to provide for future pension payments, the

data described under 2 and 3 above need not be furnished.

* * * * *

SEC. 19.165–1 [as amended by T. D. 4973, 1940–1 Cum. Bull. 65]. *Employees' trusts.*—(*a*) *Plans and trusts for employees.*—A "stock bonus, pension, or profit-sharing plan of an employer for the exclusive benefit of some or all of his employees" is a definite written program and arrangement communicated to such employees, solely designed and applied to enable such employees to share in the capital or profits of such employer's trade or business or to provide for the livelihood of such employees upon their retirement from employment. A "trust forming part of a stock bonus, pension, or profit-sharing plan" is a trust formed and availed of solely to aid in the proper execution of one of the plans defined in the preceding sentence. This phrase includes only trusts created for the exclusive benefit of employees, and does not include devices for distributing profits to shareholders. All the surrounding and attending circumstances and the details of the plan will be indicative of whether it is a bona fide stock bonus, pension, or profit-sharing plan for the exclusive benefit of employees within the meaning of Section 165.

* * * * *

(d) *Impossibility of diversion.*—As used in section 165 (a) (2), the phrase "if under the trust instrument it is impossible" means that the trust instrument must definitely and affirmatively make it impossible for the non-exempt diversion or use to occur, whether by operation or natural termination of the trust, by power of revocation

or amendment, by the happening of a contingency, by collateral arrangement, or by any other means. It is not essential that the employer relinquish all power to modify or terminate the rights of certain employees covered by the trust, but except as stated in paragraph (e), it must be impossible for trust funds to be used or diverted for purposes other than for the exclusive benefit of his employees. The diversion of substantial amounts of trust funds from one group of employees to another group of employees is not for the "exclusive" benefit of employees even though both groups were covered by the trust, if the employer (or other non-employee) receives substantial indirect benefit thereby, as, for example, through securing greater loyalty from the favored group, or through the shifting of expected pension benefits to a younger group and the postponement of part of the employer's contributions to a later date. As used in section 165 (a) (2), the phrase "purposes other than for the exclusive benefit of his employees" includes all objects or aims not solely designed for the proper satisfaction of all liabilities to employees covered by the trust.

(e) *Meaning of "liabilities."*—The report of the Senate Committee on Finance on the Revenue Act of 1938 states that the intent and purpose in section 165 (a) (2) thereof (which is identical to section 165 (a) (2) of the Internal Revenue Code) of the phrase "prior to the satisfaction of all liabilities with respect to employees under the trust" is to permit the employer to reserve the right to recover only such balance in the trust at its termination as is "due to erroneous actuarial computations

during the previous life of the trust." An "erroneous actuarial computation" means a mistake of an actuarial character reasonably made by a careful person skilled in calculating the amount necessary to satisfy pecuniary obligations depending on the average length of life of a group of individuals, and of such a type that the employer may reserve the right to recover an amount remaining in the trust because of the mistake without conflicting with the purpose for which section 165 (a) (2) was enacted. For example, if a trust created to supply pensions of $25 a month for 10,000 employees for the remainder of their lives after age 60 has been used to supply such pensions only to 500 employees, an amount remaining in the trust for this reason is not due to such a mistake, but to a change in plan; while if $25 a month after age 60 is paid to the 10,000 employees during their lives, but their average duration of life proves less than might reasonably have been expected, an amount remaining in the trust for this reason is due to an "erroneous actuarial computation." Employers might recover more than amounts resulting from such errors if the term "liabilities" included only such obligations to employees as are legally fixed and certain. Hence, the term was used in the Internal Revenue Code in its broad common meaning to include both fixed and contingent obligations to employees. For example, if 1,000 employees are covered by a trust forming part of a pension plan, 300 of whom have satisfied all the requirements for a monthly pension, while the remaining 700 employees have not yet completed the required period of service, contingent obligations to such 700 employees had nevertheless arisen

which constitute "liabilities" within the meaning of that term. It must be impossible for the employer (or other nonemployee) to recover other than such amounts as remain in the trust because of "erroneous actuarial computations" after the satisfaction of all such fixed and contingent obligations, and the trust instrument must contain a definite affirmative provision to that effect whether the obligations to employees have their source in the trust instrument itself, in the plan of which the trust forms a part, or in some collateral instrument or arrangement forming a part of such plan, and whether such obligations are, technically speaking, liabilities of the employer, of the trust, or of some other person forming a part of the plan or connected with it.

* * * * *

(g) *Proof of exemption.*—Every trust claiming exemption must prove its right thereto by filing with the collector: (1) an affidavit showing its character, purpose, activities, sources and disposition of corpus and income, and every fact which might affect its status for exemption, (2) verified copies of the trust instrument and of the employer's plan, showing all amendments, and (3) the latest financial statement, showing the assets, liabilities, receipts, and disbursements of the trust. The financial statement must be filed each year, but the documents mentioned in (1) and (2) need not be filed after the first year except when necessary to show changes occurring since the last filing.

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